

## Financial Management for Non-profit Organizations Technote

- ◆ Is your nonprofit appropriately managing its funds?
- ◆ Are your nonprofit's financial statements hard to find?
- ◆ Does your nonprofit properly track funds awarded to sub-grantees?
- ◆ Is your Non-profit prepared to respond to an audit?

### What is Financial Management

Financial management is a major responsibility of the chief executive officer and board of any nonprofit. Financial management means maintaining program budgets, bookkeeping, and keeping track of your financial statements. These are all parts of an ongoing process of monitoring your nonprofit's finances and ensuring the appropriate use of funds received. This kind of knowledge is essential to financial success.

#### 1. Types of Accounting Systems, Recording Transactions

Most accounting starts with basic record keeping (or bookkeeping). A startup bookkeeping system will probably be based on a **cash-basis system**, rather than accrual-basis. Many starting organizations, use the cash-basis system and a checkbook to track transactions. The "memo" line of the checkbook, identifies: 1) whether the check amount is an expense or credit and 2) the source or recipient of the funds.

As the organization grows, ledgers or computer software are used to track different types of financial transactions. For example, cash receipts are pasted to a cash receipts journal and checks for expenses are recorded in a cash disbursements journal.

Postings follow a single-entry or double-entry method. Double-entry works from a basic accounting equation of "**assets = liabilities + capital.**" The double-entry method makes sure that the books are always in balance. Every journal transaction has a debit entry and a credit entry. Each transaction affects both sides of the equation.

#### 2. Manual or Automated System

A record-keeping system may be based on a manual system (where entries are made and totaled by hand) or on a computer system such as Quick Books, Excel spreadsheet, or Peach Tree. (These are commonly used systems, but their mention is by no means an endorsement. Research and discuss with an accountant which system will work best for you.)

A computer-based system automates the entry of transactions by updating ledgers, generating financial statements, performing financial analysis, and creating reports needed for filing taxes.

A drawback to using a computer-based system is that the inner workings of accounting process may be underestimated. This makes the bookkeeping by hand more advantageous in a small organization. The organization must understand the mechanics behind creating financial statements and conducting financial analyses to develop an instinct for getting the most out of its financial resources.

Nonprofits not comfortable keeping their own financial records may consider

outsourcing their record/keeping activities to a business, college, university, non-governmental organization or council of government. This alternative is often used in organizations that lack the resources or expertise to maintain their own financial records.

### **3. Budgets**

An annual operating budget shows planned revenue and expenses for the coming year. Budget amounts are usually divided into major categories such as: salaries, benefits, computer equipment, and office supplies, as well as individual economic development projects or allocations to sub-grantees. Non-profit organizations might also have cash budgets, which depict the cash they expect to receive and pay out over the next month.

Capital budgets depict expenses to obtain, operate or maintain major pieces of equipment, buildings, automobiles, computers or furniture. Directors should take a strong role in developing and presenting the budget to the rest of the organization. The board is responsible for authorization of the yearly budgets.

A program budget should be developed for each major service provided to clients. It is critical to plan and track financial costs for each program. Nonprofits should strive to minimize overhead or administrative costs for supporting the entire organization. Such as rent for a building, office supplies, insurance and labor costs for personnel who support the central office. Administrative costs are often distinct from the costs associated with directly providing services of a program.

### **4. Financial Statements**

There are several types of financial statements cash flow, statement of activities, etc. The cash flow statement depicts changes in cash during the year. A statement of activities should show the changes in organizational assets over the past year.

This statement informs the organization if it is operating with extra money or at a deficit. The statement of activities also provides non-profit organizations with an accurate impression of its rate of revenue and spending. Financial statements also can signal areas of concern. They indicate the overall value of the organization at a given time by reporting total assets, less liability to ascertain the net assets of the organization.

Potential donors or funding entities will look at the financial statements of an organization to assess its level of efficiency and success. Nonprofit organizations should, and may be required, to have periodic audits. They need to talk with funding entities and the Internal Revenue Service to ensure they comply with rules and regulations pertaining to audits.

### **5. Internal Controls**

A set of internal controls is needed to guarantee that the organization is following its financial plans to protect against misallocation of funds or other mistakes and to safeguard against employee theft. Credit and criminal background checks should be conducted on any potential employees before hiring them. Establish computer protections by creating passwords to limit the number of people who can access certain types of information. Multiple signatures on each check will prevent one individual from having full control over an organization's funds.

### **Internet Resources**

[www.managementhelp.org](http://www.managementhelp.org)

[www.allianceonline.org/faqs/fmfaq10.html](http://www.allianceonline.org/faqs/fmfaq10.html)

### **Additional Resources**

- ◆ See Office of Community Development TechNote #16 Applying for 501(c)(3)
- ◆ See Office of Community Development TechNote #13 How to write a Grant Proposal
- ◆ [www.allianceonline.org](http://www.allianceonline.org) What is an audit

Adapted from Carter McNamara: [Basic Overview of U.S. Non-profit Financial Management](#)

*Additional copies of this Technote are available from the Office of Community Development, U.S. Department of Agriculture, Rural Development, Room 701, 300 7th Street, S.W., Washington, DC 20024 (1-800-645-4712). Copies may also be obtained at*

<http://www.rurdev.usda.gov/ocd>

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